Hearing Exhibit No. 92,
Corrected Pre-filed Direct Testimony -
Staff Policy Panel (SPP)

BEFORE THE
STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 11-G-0280

In the Matter Of

Corning Natural Gas Corporation

November 2011

Prepared Testimony of:
STAFF POLICY PANEL

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<u>Introductions and Qualifications</u>

Q. Staff Policy Panel, would you please state your names and business addresses.

A. Aric J. Rider, Sr. My business address is New York State Department of Public Service (Department), Three Empire State Plaza, Albany, NY 12223.

A. Michael Augstell. My business address is New York State Department of Public Service, Three Empire State Plaza, Albany, NY 12223.

A. Christopher Simon. My business address is New York State Department of Public Service, Three Empire State Plaza, Albany, NY 12223.

A. Ronald Calkins. My business address is New York State Department of Public Service, Three Empire State Plaza, Albany, NY 12223.

Q. Mr. Rider, are you the same person testifying on the Staff Gas Rates Panel?

A. Yes and my credentials are provided in the Staff Gas Rates Panel testimony.

Q. Mr. Augstell, are you the same person submitting individual testimony in this proceeding?

A. Yes and my credentials are provided in my individual testimony.

Q. Mr. Simon and Mr. Calkins, are you the same persons testifying on the Accounting Rates Panel?

A. Yes and our credentials are provided in the Accounting Rates Panel testimony.

Scope of Testimony

Q. What is the scope of the Staff Policy Panel's (Panel) testimony in this proceeding?

A. We are testifying to a three year rate plan and will provide a general overview of Staff's rate case analysis and revenue requirement recommendations. We will then address the following issues: (1) non-firm revenue sharing mechanism, (2) negotiated contract tariff changes, (3) local production revenue sharing mechanism, (4) local production write down forecast, (5) regulatory matrix incentive, (6) Leatherstocking Gas Company, (7) superior management, (8) service extensions, (9) earning sharing mechanism, (10) levelization of the incremental revenue requirements, (11) future local production credits to offset the incremental revenue requirements, (12) the Company's proposed staged increases/construction surcharge mechanism, (13) future Virgil franchise expansion, (14) exogenous costs and (15) deferral accounting. We will be addressing each of the Company's policy proposals, except for the productivity and inflation allowance which will be addressed by the Accounting Rates Panel.

Q. Are you sponsoring any exhibits?

A. Yes. We are sponsoring three exhibits.

Q. Would you briefly describe each exhibit?

A. Exhibit ___(SPP-1) contains the Company's responses to Staff's interrogatory requests (IRs).

Exhibit ___(SPP-2) contains our calculation of the service extensions that need to be removed from rate base.

Exhibit ___(SPP-3) corrected contains the calculation of our levelized revenue requirement.

Exhibit___(SPP-4) contains a copy of the news report regarding a Corning and a potential new business partner.

Q. How are the IRs responded to by the Company identified in the Panel's testimony and exhibits?

A. When we refer to IR responses, we reference the Department's assigned request number (e.g., DPS-42).

Q. Have you included the Company's entire responses to the various IRs in Exhibit___(SPP-1)?

A. Not in all cases. Due to the voluminous nature of some of the responses, we have only included those pages of the responses we deemed relevant. To the extent the Company or any other party believes we may have omitted anything of further relevance, they can supplement the record with the additional information.

General Overview

Q. Can you please provide a general overview of the Company's filed case?

A. On May 24, 2011, the Company filed for a three year rate plan using the historic test year of 12 months ended December 31, 2010. The first rate year, or rate year one, will begin May 1, 2012. The Company requested a $2,565,649 increase in gas revenues for rate year one which represents a 12.0% overall increase for the 12 months ending April 30, 2013. The Company requested a $901,464 increase in gas revenues for rate year two which represents a 3.8% overall increase from rate year one for the 12 months ending April 30, 2014. Finally, the Company requested a $583,033 increase in gas revenues for rate year three which represents a 2.3% overall increase for the 12 months ending April 30, 2015. The Company provided the Commission with the option of levelizing the rate increases over three years and using future local production credits to further mitigate its proposed increases.

Q. Can you please provide a general overview of Staff’s case?

A. Staff is also proposing a three year rate plan. The Panel is proposing a **$301,043** reduction in rate year one which represents a **-1.5%** overall decrease for the 12 months ending April 30, 2013. The Panel is proposing a **$639,112** increase in rate year two which represents a **3.0%** overall increase for the 12 months ending April 30, 2014. Finally, the Panel is proposing a **$313,672** increase in rate year three which represents a **1.7%** overall increase from rate year two for the 12 months ending April 30, 2015. We believe that the Commission has the option of levelizing the incremental revenue requirements over the three year plan. The Commission can also use forecasted local production revenues to offset the bill impacts, but should estimate them conservatively to mitigate potential rate shock.

Non-Firm Revenues

Q. What are non-firm revenues?

A. Non-firm revenues are revenues obtained from local gas production, dual-fuel and interruptible customers and negotiated contracts (revenues derived from sources other than firm customers). Generally, all non-firm revenues should be imputed into rates for the benefit of firm customers with a structured sharing between customers and shareholders to provide the Company with an incentive to maximize non-firm revenues for the benefit of both customers and shareholders.

Currently, the Company treats local production revenue in a specific manner, but negotiated contract revenues are not shared above or below the non-firm revenue forecast.

Q. What is the Company forecasting for non-firm revenues?

A. The Company is forecasting non-firm revenues of $1,665,185.

Q. Does the Gas Rates Panel agree with the Company's forecast?

A. No. The Gas Rates Panel's non-firm revenue forecast is higher than the Company's by **$116,485**.

Q. Why is there a discrepancy in the forecasts?

A. This discrepancy is addressed by the Gas Rates Panel.

Q. What is your recommendation for the treatment of non-firm revenues in the rate plan?

A. We believe an imputation for rate year one should be set at the Gas Rates Panel's forecast of **$1,781,670** and sharing percentage of 90% customer/10% shareholder should be utilized for discrepancies above or below that target. Rate years two and three should be set at the Gas Rates Panel's forecast of **$1,791,813** and **$1,801,095**, respectively. Rate year three's target should continue until changed by the Commission. We believe the sharing percentages will provide an incentive for the Company to maximize non-firm delivery revenue.

Q. How should the non-firm revenues be reconciled?

A. The Company should report on the non-firm revenues in its delivery rate adjustment (DRA) reconciliation for the rate year and pass back or recover any discrepancies through the DRA.

Q. Do you believe a tariff revision is necessary to protect customers and shareholders if there is customer migration between Service Classification (SC) No. 11 – Negotiated Contracts and firm service?

A. Yes. A tariff revision will resolve any concerns regarding migration between SC No. 11 and firm service. The Company's tariff should state that if a firm service customer transfers to SC No. 11, the Company should be allowed to exclude that customer's delivery revenue from the non-firm revenue imputation. However, the amount of delivery service revenue to be excluded should not exceed the highest annual amount for the transferring customer in the three years immediately preceding April 30th. If the SC No. 11 customer generated delivery service revenues are higher than the annual amount in the last three years proceeding April 30th, the excess delivery service revenues should be applicable to the imputation. The tariff should also state that if an SC No. 11 customer transfers to firm service, the Company should be required to include that customer's delivery revenue in the non-firm revenue imputation.

Negotiated Contracts

Q. Does Corning have the ability to negotiate delivery rates with its customers?

A. Yes. PSC 4, Leaf 148, SC No. 11 allows the Company to flex the delivery rate downward if the customer has a viable energy alternative and the customer has demonstrated an intent to utilize the alternate source.

Q. Does Corning have any negotiated contracts?

A. Yes. Corning has six negotiated contracts filed with the Commission as shown in its tariff addenda.

Q. Do you have concerns with any of these negotiated contracts?

A. We have concerns with two of these contracts.

Q. Are these contracts for firm customers?

A. No, these customers are non-firm customers.

Q. How much did it cost to connect or add additional facilities for these customers?

A. According to the responses to IR DPS-203 and IR DPS-226, the total cost of these projects was $388,700 and $866,450.

Q. Did these customers pay for the facilities?

A. Corning claims there was a contribution in aid of construction given in the form of a minimum bill payment.

Q. How is Corning treating the revenues it collects from these customers?

A. The Company accounts for these revenues in the same manner as any firm customer and has not offset any of the plant costs.

Q. Does the Panel agree with Corning treatment of the revenue for these two negotiated contracts?

A. No.

Q. Please explain the Panel's concerns with the way in which Corning has treated these revenues.

A. Since these customers have an alternative energy source and are eligible for negotiated rates, they should pay for the cost of the connection or additional facilities so that if they leave the system, firm customers are not left with having to pay for the stranded assets. Corning, however, has not offset any of the project costs. Simply stated, Corning's core customers assume the risk of paying for the plant if these negotiated contract customers leave the system.

Q. Does the Commission's regulations detail the portion of service which the Company is required to install without charge for interruptible or dual-fuel nonresidential customers (<u>i.e</u>., negotiated contracts)?

A. 16 NYCRR §230(2)(f), states, in part, that "[e]ach corporation's obligations with respect to applicants for interruptible or dual-fuel nonresidential service shall be governed by tariffs approved by the commission."

Q. Does Corning's tariff detail its responsibility with respect to the amount of service it is required to install without charge for interruptible or dual-fuel nonresidential customers?

A. No.

Q. Does the Panel recommend that the Commission place rules in the Company's tariff that governs extensions of service and additional facilities for non-residential interruptible, dual-fuel and negotiated contract customers?

A. Yes. Corning should be required to add language to its tariff that addresses: (1) non-residential interruptible, dual-fuel and negotiated contract customer obligations to pay for connections and upgrades over a reasonable amount of time, (2) non-residential interruptible, dual-fuel and negotiated contract customers' contracts should clearly identify the charges for delivery service and clearly identify the charges for facilities and (3) how the Company treats revenues for delivery service and charges for facilities from non-residential interruptible, dual-fuel and negotiated contract customers.

Q. What facilities should be provided for free for non-residential interruptible or dual-fuel customers?

A. No plant should be provided for free. These customers are non-firm and can leave the system at any time. Therefore, the goal should be to have all of the assets written off as soon as possible, but no longer than five years.

Q. Why do you believe that five years is the maximum amount of time that should be allowed for non-residential interruptible or dual-fuel customers to pay for service extensions or upgrades?

A. We believe it strikes a balance between the customer’s need for service and the risks placed on core customers. It also mirrors the development period allowed in the franchise expansion policy statement in Case 89-G-078 (issued December 11, 1989).

Q. Going forward, how do you believe the Commission should treat the revenues and plant associated with the two non-firm customers discussed above?

A. We believe the Commission has two options: (1) include all of the revenue in the non-firm revenue target and put the Company at risk of writing off the undepreciated plant if these customers leave the system or (2) exclude a portion of the revenues from the non-firm revenue target and use that revenue to write down the plant over five years.

Q. What do you recommend?

A. We opt to reflect all of the revenues in the non-firm revenue target and believe the Company should be put at risk of writing off the undepreciated plant if either of these customers leave the system to provide the maximum benefit to firm customers now, recognizing that there was no tariff language in place to govern the treatment of the revenues and expenses.

Q. How should the Commission track these plant investments?

A. Corning should be required to report on these two specific investments in its annual report to the Commission.

Local Production Revenue

Q. How has the Commission treated local production revenues?

A. In Case 07-G-1359 the Commission developed an imputation of $250,000 for any local production revenue and allowed 90% customer/10% shareholder sharing above the imputation. It is important to note that the Company only had the monthly meter charges and daily access rates at that time. In Case 08-G-1137 (issued August 20, 2009) the Commission developed specific treatments for local production access revenues and local production transportation revenues. The Commission continued the $250,000 imputation for the local production access revenue with an 80% customer/20% shareholder sharing mechanism above and below $250,000. The Commission also specified the treatment that required an accelerated write down of the investment for local production plant using 100% of transportation revenues generated by a fixed monthly charge and 80% of transportation revenues generated by volumetric charges. Corning's shareholders retain 20% of the transportation revenues generated by volumetric charges while the plant is being written down, however, if production ceases before the investment in rate base is entirely written down, Corning's shareholders are required to bear the cost of writing down the remaining investment up to the amount retained via its 20% share. Once the plant is fully written down, the revenues would be shared 80% customers/20% shareholders between customers and shareholders, respectively.

Q. What did Corning forecast as the access revenue for each of the three rate years?

A. Corning forecasts $530,684 for each rate year.

Q. How does the Company propose to treat local production revenues in this case?

A. The Company has not proposed to change the current $250,000 imputation for access revenues or the sharing mechanism for transportation revenues as stated in its response to IR DPS-58.

Q. If the Company constructs facilities to provide transportation service to gas producers in Corning's service territory during the term of the rate plan, how does the Company propose to treat the costs and revenue?

A. In the response to IR DPS-110, Corning offered two options: (1) "Any investment made in the period between rate cases will not be afforded rate base treatment until the next case; but the Company would be permitted to retain all revenues generated from additional connections to local production. The investment amount and associated depreciation would be included in rate base in the next base rate case and the revenue would be shared 80%/20% between customers and shareholders, respectively, consistent with accounting treatment previously approved by the Commission for the Root Pipeline and Compressor Station project;" or (2) "A capital tracker can be established for these types of projects that would permit the Company to recover carrying charges (pre-tax overall rate of return, depreciation expense and property taxes). Any revenue would be shared 80%/20% between customers and shareholders, respectively, consistent with accounting treatment previously approved by the Commission for the Root Pipeline and Compressor Station project."

Q. Does the Panel agree with the Company's proposal for local production revenues?

A. No.

Q. Should the Commission continue an imputation for the access revenues?

A. Yes, but it should be increased to $545,284, which reflects our estimate of the Company's volumetric forecast.

Q. Why should the imputation be increased?

A. The imputation needs to be increased to account for the increase in local production access revenues we forecasted. All utility revenues should be accurately forecasted in the rate year to offset firm customers' revenue requirement.

Q. Do you believe the 80% customer/20% shareholder sharing above and below the imputation for access revenue should continue?

A. No. The sharing should be changed to 90% customer/10% shareholder.

Q. Why?

A. The 80% customer/20% shareholder sharing split was developed through negotiations in the last rate case that resulted in the adoption of a Joint Proposal (JP) by the Commission. The JP reflected an overall agreement on numerous issues, including local production revenue sharing, but does not necessarily reflect Staff's current litigation position on this issue. For example, the Commission has previously set

90% customer/10% shareholder non-firm sharing percentages in the last two litigated gas rate cases, Case 08-G-0888 (issued June 22, 2009) and Case 07-G-0141 (issued December 21, 2007).

Q. Are local production revenues firm revenues?

A. No they are not, and that is why the associated plant is currently being written off.

Q. How should the transportation revenues be treated?

A. The treatment of the transportation revenues, both monthly fixed and volumetric rates, should follow the procedure in Case 08-G-1137, discussed above, until the plant is completely written off. Then, the sharing should be modified to 90% customer/10% shareholder on any existing local production transportation revenues.

Q. Why should the mechanism be modified after the plant is written down?

A. Shareholders no longer have the risk of writing down plant investments. Therefore, they should not be entitled to a higher percentage of those revenues.

Q. If the Company constructs facilities to provide transportation service to gas producers in Corning's service territory during the term of the rate plan, how should the Commission treat capital expenditures?

A. Gas producers should be treated like interruptible or non-firm dual fuel customers because the production can vary from well to well, may produce for only a short time or may not produce at all, as Corning has stated. Therefore, gas producers should pay for the capital expenditures necessary to attach to the distribution system. If the Company allows the gas producers to pay for the plant over a reasonable time, then the Company should not be allowed a return on that plant until the next base rate case as the Commission determined in Case 09-G-0791 (issued June 23, 2010) and any stranded costs should be borne by the Company’s shareholders.

Q. If the Company constructs facilities to provide transportation service to gas producers in Corning’s service territory during the term of the rate plan, how should the Commission treat those revenues?

A. To encourage additional attachments, we recommend an 80% customer/20% shareholder sharing on any new local production connections using the same approach established in Case 08-G-1137 until the plant is fully written down and then the sharing mechanism should revert to 90% customers/10% shareholders.

Local Production Write Down Forecast

Q. Did the Company forecast the accelerated recovery of plant for the Root Well and Compressor Station project?

A. Yes. The Company forecasted $1,234,634, $0 and $0 for rate years one, two and three, respectively.

Q. Did you forecast the level of transportation revenue that would be used to write down the Root Well and Compressor Station project?

A. Yes. Using the Company’s forecasted volume and the contract rates, we estimated a write down of $1,026,756 in rate year one and the remaining plant balance of $231,339 would be written off in rate year two.

Q. Did you provide your forecast to the Gas Rates Panel?

A. Yes.

Regulatory Matrix

Q. When was the Regulatory Matrix established?

A. The Matrix was established in Case 05-G-1359 (issued May 22, 2006) when Corning’s previous management placed the health and safety of ratepayers at risk by pursuing financial and operational policies that significantly undermined the Company’s ability to provide safe and adequate service.

Q. What did the Commission require Corning to do?

A. The Commission ordered the Company to institute a variety of health, safety and accounting reporting requirements and gas procurement and capacity asset management practices, and if it failed to implement these requirements and practices, it incurred a monetary incentive that resulted in the establishment of certain regulatory liabilities on the Company’s books to compensate ratepayers for the poor performance of its management.

Q. Was the Regulatory Matrix continued in Corning’s 2007 rate filing?

A. Yes.

Q. Was the Regulatory Matrix continued in Corning’s 2008 rate filing?

A. Yes, but the Signatory Parties to the JP agreed that if the Company did not incur any liabilities during the rate year, it could file for permission to remove the Regulatory Matrix and Staff would support the Company’s filing, if it believed that the Company met all of the requirements for the rate year.

Q. Did Corning file a petition with the Commission for the removal of the Regulatory Matrix?

A. By letter dated August 10, 2010, the Company filed for the removal of the Regulatory Matrix.

Q. Did the Commission act on Corning's petition?

A. Yes. The Commission decided in Case 08-G-1137 (issued May 19, 2011) that Corning's performance under the Regulatory Matrix indicated that although it complied with all of the accounting and gas supply components, Corning failed to submit the required reports to the Commission on its annual cathodic protection efforts on both November 1, 2009 and November 1, 2010 and incurred two gas safety related liabilities for the failure to timely provide these reports. The Commission found that Corning incurred a regulatory liability totaling $65,500 ($32,750 for each occurrence) which should be deferred for future rate payer benefit. The Commission also found that Corning had been able to comply with the accounting and gas supply reporting requirements, and most of the safety related requirements, and discontinued those portions of the Regulatory Matrix. However, the Commission continued the existing gas safety reporting criteria pertaining to the cathodic protection requirement included in the Matrix. The incentive for the annual cathodic protection reporting requirement was set at $32,750.

Q. Have you reflected the $65,500 ratepayer credit in Staff's presentation?

A. Yes. The Accounting Rates Panel reflected this customer benefit.

Leatherstocking Gas Company

Q. What is the Leatherstocking Gas Company, LLC (Leatherstocking)?

A. Leatherstocking is a local gas distribution company joint venture, between Mirabito Holdings, Inc (Mirabito) and Corning located at 330 West Williams Street, Corning, New York, which is the same address as Corning.

Q. Did Corning address Leatherstocking in this rate case?

A. There is no mention of Leatherstocking in its multi-year rate filing.

Q. How did Staff become aware of the existence of Leatherstocking?

A. Staff obtained a news article dated June 2, 2011, in the Evening Sun titled “Pipeline interest eyes in southern Chenango.” The article states, “A natural gas public utility has acquired franchises to service at least two businesses in neighboring Delaware County and has plans for future municipal and corporate agreements in southern Chenango. The pipeline system, built by Leatherstocking, would be the first in over 50 years to deliver natural gas to the region. It would span about 15 miles and connect both existing and planned natural gas wells, according to Corning Natural Gas President and Chief Executive Office[r] Mike German. The Corning-based company recently partnered with Mirabito Holding Inc. of Binghamton to form Leatherstocking Gas” (Exhibit ___(SPP-4)).

Q. Did Staff submit IRs to the Company concerning Leatherstocking?

A. Yes. Staff issued IRs DPS-10 and DPS-100.

Q. What information did Staff receive regarding Leatherstocking in response to DPS-10?

A. The Company’s response to DPS-10 provided the initial background information about Leatherstocking. The key points are as follows: (1) discussions between Corning and Mirabito were initiated in the summer of 2010, (2) Leatherstocking was formed on November 1, 2010,(3) there was an initial investment of $5,000 separately provided by both Corning and Mirabito,(4) there are three Corning employees that serve as Leatherstocking managers and one Corning employee serving as the Corporate Secretary and (5) there were no legal expenses paid during the test year and that all legal costs were paid in 2011 and recorded on the Company's books in below the line accounts.

Q. What information did the response to DPS-100 provide Staff?

A. According to the Company's response: "The Company estimates that less than 1% of normal business hours of his time [Mike German], as well as that of Vice President Russell Miller, was spent on this activity [Leatherstocking] from the summer of 2010 through December 2010. For 2011 and going forward, the time spent by Company Officers or other employees on Leatherstocking activities during the normal business hours can be determined from time sheets or other records. The Company is in the process of compiling that information and will provide it shortly" (Exhibit

___(SPP-1)). The Moonstone Consulting firm, which provides services to Corning, had knowledge of the formation of the new entity, “but did not have responsibility for any specific tasks pertaining to the establishment or plans for operations of Leatherstocking and did not undertake any such work from the summer 2010 through December 2010. The same is true for 2011” (Exhibit ___(SPP-1)). The Company revealed that there were legal expenses associated with Leatherstocking during the historic test year. Nixon Peabody spent time on matters having some relationship to Leatherstocking from late summer 2010 through December 31, 2010. $3,745 should be normalized out of the historical test year (Exhibit___(SPP-1)).

Q. How does Staff propose to handle Leatherstocking in the context of this rate case?

A. Staff is unable to ignore the potential impact of the Leatherstocking’s activities on Corning’s ratepayers. While the Company may be content with classifying Leatherstocking as “effectively a non-operating entity at this time” (Company response to IR DPS-100 question 3), Staff is attempting to forecast a three year rate case and must assume that Corning will continue to pursue Leatherstocking activities into the future. When addressing the public, the Company has previously attached its name alongside the Leatherstocking name which presumably provides more credibility to Leatherstocking and certain Company personnel will continue to allocate some of their time to this new entity along with Company property and resources. As a result, Staff is proposing to allocate 10% of certain Corning costs to Leatherstocking to protect Corning’s core customers from any cross-subsidization. When, and if, the Commission approves a certificate of convenience and public necessity for Leatherstocking, cost allocation rules should be established to protect Corning’s core customers permanently.

Q. What costs does Staff propose to allocate to Leatherstocking?

A. Staff is proposing to allocate a portion of labor, for only those Corning employees that are also Leatherstocking employees, along with the associated payroll taxes, insurance, building expense, transportation, outside services and property taxes.

Q. What is Staff’s basis for the 10% allocation?

A. Staff is estimating that the four employees will spend approximately half a day a week working on Leatherstocking matters. One half day out of five equals 10%.

Q. How can Staff estimate 10% of Corning employees time will be on Leatherstocking when the Company stated in response to IR DPS-100 that “less that 1% of normal business hours” would be spent on Leatherstocking?

A. Staff issued IR DPS-106 requesting official work hours for the four Corning employees that are also Leatherstocking employees. The Company informed Staff that official working hours are from 8:00 AM to 5:00 PM. Staff also requested a detailed timesheet for Corning employee Stanley Sleve. The Company responded by stating, “Mr. Sleve and other officers of the Company only indicate hours worked on timesheets” (Exhibit ___(SPP-1)). Staff followed up with IR DPS-225, in which the Company stated that all four employees are governed by the Fair Labor Standards Act (FLSA) and are exempt from FLSA overtime rules.

Q. Why is this significant?

A. Currently the four employees in question only account for the fact that they worked on any given day and are unable to distinguish between projects. Being covered by the FLSA would typically mean that the employee would be eligible for overtime compensation. However, these employees are exempt from overtime, meaning that they would receive the same salary if they worked 80 or 30 hours during a week. So when the day officially ends at 5:00 PM, these employees cannot just switch over to work on Leatherstocking, they are still being compensated as Corning employees on behalf of Corning’s rate payers. Given these facts, Staff feels comfortable in using the estimated 10% factor to account for Leatherstocking activities.

Q. What is the financial impact on rates for the 10% cost allocation for Leatherstocking during the rate year?

A. Staff will detail the specific adjustments to each expense in the Accounting Rates Panel’s testimony.

<u>Superior Management</u>

Q. Has the Company requested that a superior management performance incentive be considered in determining the cost of equity?

A. Yes. The Company believes that it should be granted a 50 basis point premium to the allowed calculated return on equity (ROE) in order to recognize innovative and superior performance that it believes it has provided and will continue to provide to the benefit of its customers.

Q. Has the Commission granted a performance premium in prior cases?

A. Yes, but very rarely. In the Rochester Telephone Corporation (RTC) case (17 NY PSC 448 (1977)) the Commission determined that a calculated ROE of 12.75% plus a .25% premium for creative management and innovation totaling a 13.00% ROE was justified.

Q. What efforts did RTC make to demonstrate its innovation and creative management efforts?

A. RTC demonstrated a commitment to efficiency and productivity by reducing its employee level by 2.0% from 2,749 to 2,693 and reflecting additional savings from a productivity adjustment in rates. Specifically, RTC was the first company in the Rochester area to devise a liberalized interconnection system to stimulate new competitive equipment offerings to customers and a program that may have been the first in the country to offer for sale to customers, installed terminal equipment and wiring.

Q. Did RTC seek a premium on ROE for innovative and creative management following the 1977 rate decision?

A. Yes, in Opinion 80-38 in Case 27411 (issued December 1980) a 0.10% premium on ROE was disallowed by the Commission as shown in response to IR DPS-108. It appears that the rationale for the denial was the level of consumer complaints about certain provided services and that the previous 1977 premium was perpetual in nature and had enabled RTC to increase its earnings, retention and equity ratio. The Commission further noted that the allowed ROE was adequate in all respects and that awarding a return premium is a matter of discretion and RTC had failed to make a convincing argument to justify a return premium.

Q. Has the Commission denied other utility rate requests for a premium on ROE award?

A. Yes. The Brooklyn Union Gas Company (Opinion No. 82-23 Case 28107 (issued October 19, 1982) was denied a 0.25% premium award by the Commission. The Commission, although commending the Brooklyn Union Gas Company’s efforts in providing savings, stated they did not rise to an extraordinary level and denied the request. The National Fuel Gas Distribution Corporation (Case 89-G-179 (issued July 19, 1990)) requested an extra equity return award for management excellence which was denied by the Commission.

Q. Has the Company identified the criteria which it believes the Commission considers when granting an award for superior management performance?

A. Yes. Although the Commission has not established specific standards the Company identified the following criteria: first, the utility’s actions must be innovative; second, such actions must be beyond what the utility is required to do in its day-to-day operations; that is, something the utility is not already required by law to do in performance of its public service obligations; and, third, the utility must provide a benefit to customers, whether monetarily or otherwise in either the near or long-run.

Q. Has Corning identified the accomplishments that it believes merit consideration for awarding a superior management performance award of 0.50% of ROE?

A. Yes. The Company believes that it has developed and expanded the business of transporting locally produced natural gas from the wellhead in the Company's system and interstate pipelines, specifically the Root Pipeline project. The Company also notes that customers will benefit from the Root Pipeline project from transportation revenues and lower overall gas costs. The Company states it has actively pursued the expansion of the customer base which provides service to new customers, while reducing the costs to all customers by spreading the fixed costs over a broader base. The Company also believes it has successfully lowered its debt costs through refinancing at lower rates and new equity was issued without the need for underwriters. Additionally the Company negotiated an agreement with an asset manager that supports a gas supply plan that uses stored gas and not financial hedges.

Q. Does the Panel consider Corning's accomplishments to be extraordinary in nature and warranting a premium on ROE?

A. No. All of Corning's actions fall under the criteria that all gas utilities should strive to achieve in their normal course of business operations. A gas utility should be expanding its transportation and distribution infrastructure as needed, seeking the lowest available prices for gas, assuring a reliable gas supply, expanding its customer base, issuing new debt at the lowest cost rate and refinancing existing debt at better terms.

Q. Does the Company's pursuit of local production revenues warrant a superior management premium consideration?

A. No. The Company has neglected to mention that the ratepayers' 80% share of access revenue will be initially used to offset the project's cost of $2.7 million. Due to the concerns that the Root Pipeline and the pipeline upgrade project may not be economically viable, it was decided that the investment should be recovered through a dedicated revenue stream as rapidly as possible, thereby, lessening the potential financial impact and risk to the Company and its customers. Also, the Company is receiving a 20% share of the Root Pipeline transportation revenue which exceeds the normal 90% customer/10% shareholder standard sharing on non-firm revenues. This additional 10% share of non-firm revenues currently received by the Company can be viewed as a reward for its efforts, when considering that the ratepayers' revenue share at this time is being fully applied against the cost of the investment. Therefore, the Company has already been compensated for its efforts in this regard.

Q. Did the Company claim that its delivery customers would see savings of $700,296 annually from flow through mechanisms?

A. Yes, on page 11 of Company witnesses Sarhangi's and DiValentino's pre-filed direct testimony.

Q. Do you agree with the estimate?

A. No. We believe there are problems with the estimate.

Q. Please explain.

A. First, the Company forecasted local production volumes at 60,000 Mcf per day in its calculation of savings for customers, but only forecasted 42,000 Mcf per day in its local production revenue forecast. Second, the Company estimates additional capacity release credits, however, customers will not receive any additional revenue under the current asset management agreement. Third, the Company calculated a savings level using transportation revenue in the numerator and not in the denominator. These errors overstate the estimated benefits. Based on the foregoing, we believe that customers bills will be higher in rate year one.

Q. Is the Company currently subject to a earnings sharing mechanism (ESM)?

A. Yes. Under the JP approved in Case 08-G-1137 (issued August 20, 2009), the Commission allowed the Company an opportunity to earn a ROE of 10.70% with the ability to fully retain earnings within a 115 basis points deadband which equates to an 11.85% ROE before a 50/50 sharing of earnings with ratepayers commences. For the fiscal year ending August 31, 2010, the Company earned a ROE of 11.31% which it fully retained because the equity earnings did not exceed the 11.85% sharing threshold as shown in the ESM calculation provided by Corning on December 17, 2010. The ESM has allowed the Company to be rewarded an additional premium by controlling costs and as a result retained $63,500 of after tax earnings.

Q. Are there any other factors that need to be addressed regarding the Company’s request for a superior management performance incentive?

A. Yes. The Company’s acquisition of least cost available gas is a standard practice and is required by Public Service Law §66(f). The Company is required by the Commission to have a plan and to meet its winter storage requirements, whether by performing the task in house or utilizing an asset manager. This is not a unique circumstance.

Q. Are there any other factors that mitigate the Company's request for a superior management incentive?

A. Yes. As discussed above, the Company has allowed full-time salaried employees to simultaneously hold positions with a separate utility, Leatherstocking, without allocating costs to this entity, to the detriment of Corning's customers. Moreover, Corning is required to submit a yearly report, by August 5th of each year, to the Director of the Office of Industry and Government Relations on the feasibility of the Company's study regarding purchase of receivables. It failed to submit the report, as shown in IR DPS-18. Similarly, Corning was required to file an annual rate of return for its Virgil franchise expansion due on March 31, 2011. Corning filed it with the Commission on July 21, 2011. The Company is required to file contracts with the Commission 30 days prior to their effective date per the Company's tariff SC No. 11.

Corning has violated this rule repeatedly. In addition, the Commission recently subjected the Company to a regulatory liability for failing to timely submit cathodic protection reports. In sum, the Company continues to demonstrate an inability to comply with certain deadlines, which runs contra to its request for a superior management incentive.

Q. Are you opposed, in principle, to a company's ROE being adjusted from the "base" rate calculated by Staff's traditional methodology?

A. No. As the Company pointed out, the Commission has done so in the past.

Q. What factors might the Commission consider when deciding to deviate from the calculated ROE?

A. As discussed, it is up to the Commission to articulate what measures it feels warrant a deviation from its traditional cost of equity setting methodology. We believe things that might be considered include whether a company's management has gone above-and-beyond the ordinary course of business to achieve material savings for customers, improve customer service in some novel ways, or has significantly advanced public policy goals in unique ways.

Q. Are there any other areas the Commission might consider?

A. Yes. The business and financial risk of a utility, in particular in light of the rate plan being approved, must be considered. If the plan adds substantial business risk to the utility’s operations relative to a “typical” rate plan, for instance by eliminating many reconciliations, an upward adjustment might be warranted.

Q. Should such adjustments only result in increases to the base ROE?

A. No. It is possible that management has acted in an imprudent manner, by causing financial harm, materially decreasing the level of customer service received by customers or failing to adequately address public policy initiatives and the company could be penalized through such an adjustment. Likewise, the ROE could be lowered if a rate plan includes a much lower level of business risk relative to the rate plans of other utilities.

Service Extensions

Q. Are there rules that govern new main and service extensions?

A. Yes. The regulations can be found in 16 NYCRR §230. The Company has rules in its PSC tariff No. 4, beginning on leaf 19, that reflect these regulations.

Q. Can you briefly explain those regulations?

A. The customer must first assure the utility that he/she will be a reasonably permanent customer (i.e., a firm customer) and agree in writing to pay the corporation for the material and installation costs beyond the portion which the utility is required to install without charge, any surcharge related to the material and installation costs beyond the portion which the utility is required to install without charge, rates charged and possibly a security deposit. A firm residential non-heating customer receives up to 100 feet of main and a service line necessary to reach the edge of the public right-of-way. A firm residential heating customer receives up to 100 feet of main and up to 100 feet of service. A firm non-residential customer receives up to 100 feet of main and any service line located in the public right-of-way. Rules for interruptible or dual-fuel nonresidential service extensions are governed by tariffs approved by the Commission.

Q. How many customers did Corning attach to its system, excluding the Virgil franchise area, between January 2009 and July 2010?

A. According to its response IR DPS-202, Corning attached 54 customers.

Q. Of those 54 customers, did Corning provide firm customers with additional footage of service over what is allowed per its tariff?

A. Yes. Corning charged eight customers for the excess, but failed to bill 18 customers.

Q. What is the impact of providing additional service extensions for free?

A. When the Company files for a base delivery rate increase, the Company earns a return on the excess footage as well as additional depreciation expense. Essentially, all other customers subsidize the footages beyond what is given for free by the Company. Also, Corning could have earned additional revenue in its Revenue Decoupling Mechanism (RDM) if the customer connected because of the free footage, since Corning's RDM is calculated on a revenue per customer basis.

Q. Should Corning earn a return on, and collect depreciation expense for, the footages it gave away for free?

A. No. We propose to reduce rate base and associated depreciation expense by the excess level. Corning should also be required to remove the plant from rate base (not its continuing property records) so that this adjustment does not have to be made in each of the Company's subsequent rate filings.

Q. How did you calculate an adjustment of $29,786?

A. We took the forecast cost for a new service line divided by the average footage of a new service which equaled $13.25 per foot. We then multiplied that average cost per foot by the excess footage of 2,248, as shown in Exhibit ___(SPP-2).

Q. Do you have any other recommendations?

A. Corning should develop procedures that comply with the Commission's regulations and its tariff, train its staff and provide an annual report with the Commission over the term of the rate plan so that Staff can monitor the Company's compliance.

Earnings Sharing Mechanism

Q. As part of the three year rate filing, is the Panel proposing an ESM?

A. Yes. Due to the forecasting of the revenue requirements for the three rate years spanning May 2012 through April 2015 we believe an ESM is warranted. The ESM serves as a safeguard for customers should the rate year forecasts prove to be materially inaccurate with respect to items such as expenses, revenues from customer classes not subject to an RDM or rate year capital structure. If there is a forecast error and the Company incurs a materially negative impact, the Company has the option of requesting deferral authority or applying for rate relief. Conversely, should the forecast error result in an achieved ROE significantly higher than allowed in rates, then the lack of an ESM leaves ratepayers with no recourse, unless the plan is terminated through procedures like a show case order.

Q. Does Corning's current rate plan in Case 08-G-1137 have an ESM?

A. Yes, the current rate plan reflects an authorized ROE of 10.7%, and the ESM has a 115 basis points deadband that enables Corning to retain earnings up to 11.85%. The sharing of earnings with customers begins when the ROE exceeds 11.85%.

Q. Did the Company realize excess earnings in 2010?

A. Yes, the excess earning calculation prepared by Corning submitted December 17, 2010 shows it earned an ROE of 11.31%, but no earnings were shared with ratepayers because they fell below the threshold of 11.85%

Q. How does the ESM function?

A. At the end of the rate years the Company would provide a computation of its gas rate of return on common equity, using the average debt and common equity capitalization reflected on the Company's books during the applicable period. The Company would file the computation and the supporting workpapers no later than 120 days following the end of each rate year. The ROE calculation should be based on traditional ratemaking practices and methodologies applicable to Corning and include revenues, expenses, capital structure and rate base. The average earned ROE would be calculated from Corning's books of account for the applicable rate year, but the earnings calculation would exclude the shareholder’s portion of the Lost and Unaccounted for (LAUF) incentives, the shareholder’s portion of revenues from the receipt of local production gas, gas safety and reliability incentive and Regulatory Matrix-based liabilities. The earnings computations would reflect the lesser of (i) and equity ratio of 50.0% or (ii) the Company’s actual average common equity ratio. The actual average common equity ratio would exclude all components related to “other comprehensive income” that may be required by generally accepted accounting principles; such charges are recognized for financial accounting reporting purposes, but are not recognized or realized for ratemaking purposes.

Should Corning’s average earned ROE in any of the rate years exceed an earnings threshold of 9.70% (See Augstell Testimony), the amount in excess of 9.70% would be deemed shared earnings. Customers would be allocated the following percentages of earnings:

- Earning up to 9.70% are kept by the Company;
- for the first 50 basis points of shared earnings (i.e., earnings in excess of 9.70% and up to and including 10.20%), 50% of such shared earnings;

- for the next 50 basis points of shared earnings (i.e., earnings in excess of 10.20% and up to and including 10.70%), 75% of such shared earnings; and,
- for additional shared earnings (i.e., earnings in excess of 10.70%), 90% of such shared earnings.

Amounts allocated to customers under the above formulas would be deferred on Corning's books for future disposition by the Commission. The shared earnings deferred for the benefit of customers should accrue carrying charges at the Company's authorized pre-tax rate of return. If the average earned ROE is less than the 9.70% earnings sharing threshold in any of the three rate years, any such shortfall would be deducted from the shared earnings earned by the Company in the other periods.

Q. Do you recommend updating the cost of equity?

A. Yes. Prior to a decision by the Commission in this case, we recommend that the ROE be updated using Staff witness Augstell's methodology outlined in his pre-filed direct testimony.

Levelization

Q. Did the Company propose to levelize its rate increases over the three year rate plan?

A. Yes. The Company proposed to levelize its rate requests over three years, claiming it would need to increase rates by $1,429,281 each year.

Q. Does the Panel believe that the Commission has the option to levelize the rate request to mitigate bill impacts?

A. Yes.

Q. Did you develop a levelized revenue requirement for the three year plan?

A. Yes. As shown on **Exhibit ___(SPP-3) corrected** our levelized revenue requirement for the three year plan is **($15,046)**.

Q. Do you believe that the Company should apply the pre-tax rate of return on any balances?

A. No. We believe that the Other Customer Provided Capital Rate is appropriate. The purpose of mitigating rates is to provide consistent and equivalent rate increases over the course of the rate plan in order to minimize rate fluctuation and bill impacts on customers, not to enrich any one party. The Other Customer Provided Capital Rate is more indicative of short-term borrowing rates; thus, if the Company were to borrow money on a short-term basis to cover costs, the Other Customer Provided Capital Rate is more representative of the rate in which those costs would be financed. Over the last five years the Other Customer Provided Capital Rate on average is equal to roughly half of the pre-tax rate of return rate requested by the Company. Consequently, the use of the pre-tax rate of return would unfairly over-compensate Corning. It would be counterproductive to levelize rates with the purpose of minimizing bill impacts on customers and then burden them with excessive carrying charges. Furthermore, the Other Customer Provided Capital Rate is consistent with Case 09-E-0428 (issued March 26, 2010)(Consolidated Edison).

Q.   Do you have any concerns with levelizing the rate request?

A.   We have one concern. If levelization is accomplished by designing base rates for a levelized revenue requirement, the Commission should be aware that rates can be set either too high or low at the end of the rate plan. Delivery rates will most likely need to be designed for the rate year following the rate plan to correct for this problem. If levelization is handled in a surcharge/credit, and the surcharge/credit is eliminated at the end of the third rate year, the concern is moot.

<u>Deferred Credit to offset Rate Increase</u>

Q. Did Corning propose to mitigate its rate increases to customers using deferred revenues from local production transportation revenue?

A. Yes, the Company forecasted local production transportation revenue over the three year rate plan of $2,769,804 and proposed that a credit amounting to $844,992, $804,203 and $781,666 be applied in rate year one, two and three, respectively. The Company proposed use of deferred accounting to track the amount credited to customers equals the actual revenue collected. Corning recommended that the pre-tax rate of return be applied to any outstanding balances.

Q. Does the Panel believe this mechanism can be used to mitigate bill impacts?

A. We believe that the proposal has merit, but we are concerned about future rate shock or bill volatility.

Q. Please explain.

A. As Staff witness Colby points out in his pre-filed direct testimony, we have no reason to dispute the

Company’s local production forecast. However, we are concerned with the potential impacts should the Company’s forecast not materialize.

Q. Why is the Panel concerned?

A. In the last rate case the Company said local production was risky, and, therefore, the Commission approved writing down the asset. The risks are still there until the plant is fully written off and yields additional revenues. In the event local production ceases before plant write down, then there is no revenue.

Q. What could happen to customer’s bills if the Commission used the Company’s mitigation forecast and the local production revenues did not materialize?

A. Customers would experience rate shock at the end of the rate plan and would have to make up the difference between the forecasted revenues and the actual revenues.

Q. What level of local production revenue do you believe should be available to mitigate rate impacts?

A. We believe that the Commission should use a conservative approach and use a current throughput level of 30,000 Mcf per day. Using such an assumption, a total of $844,830 would be available for rate mitigation.

Q. Will customers get the benefit of the local production credit under your proposal?

A. Yes, if the Commission uses the local production credit, customers would benefit from the mitigation and, if the Company's forecast is accurate, customers will be provided any credits above the rate mitigation forecast through the DRA. The benefit of this proposal is that it substantially minimizes the potential for future rate shock.

Q. How should the credit offset operate?

A. The $844,830 should be divided by three, and $281,610 should be credited to firm customers through the DRA.

Q. Do you believe that the Company should apply the pre-tax rate of return on any balances?

A. No. We believe that the Other Customer Provided Capital Rate is appropriate as previously discussed.

Staged Increases/Construction Surcharge Mechanism

Q. Did the Company propose staged increases for the twelve months ended April 30, 2016 and April 30, 2017?

A. Yes.

Q. Did the Company describe how the staged increases would operate for the twelve months ended April 30, 2016 and April 30, 2017?

A. The Company stated in its pre-filed direct testimony that it would recover carrying costs defined as the pre-tax overall rate of return, depreciation expense and property taxes on incremental plant additions over the previous year.

Q. Did the Company claim that there is precedent for staged increases?

A. The Company claims that the Commission provided staged increases for Corning in its last rate case, as well as historic Orange and Rockland rate cases.

Q. Did the Company also propose an alternative to staged increases for the twelve months ended April 30, 2016 and April 30, 2017?

A. Yes. The Company proposed a construction surcharge mechanism (CSM).

Q. Did the Company describe how the CSM would operate for the twelve months ended April 30, 2016 and April 30, 2017?

A. The Company stated that it would be permitted to establish a surcharge factor to be applicable to all delivery customers (except those SC 7 customers with contractually determined prices) that would recover carrying costs defined as return, depreciation and property taxes on projected infrastructure investments. The Company would reconcile the carrying costs collected to actual amount due to the Company based on actual investments and any difference would be included in the following year's CSM. The Company proposed to present a plan to the Commission on an annual basis for its review and approval. The investment amount would become the basis for the establishment of the surcharge rate. At the end of the annual period the Company would generate a report detailing the investments made and a calculation of any over or under collection, and file the report within 60 days.

Q. Did the Company claim that there is precedent for a CSM?

A. The Company cited an American Gas Association (AGA) fact sheet dated April 2011 which claims that more than 50 utilities in 19 states serving 20 million residential natural gas customers are using special rate mechanisms to recover their replacement infrastructure investments. The AGA claims that 13 utilities in six states serving six million customers are recovering these investment costs using rate stabilized tariffs.

Q. Does the Company have a preference as to which mechanism they would use for the twelve months ended April 30, 2016 and April 30, 2017?

A. The Company's response to IR DPS-68 states that the Company prefers the CSM.

Q. Does Staff have concerns with the Company's proposal?

A. Yes. There is insufficient capital spending documentation provided by the Company; truing up all capital expenditures is a "blank check" for the Company which can lead to high bill impacts; surcharging customers volumetrically will lead to higher bill impacts for high use customers which is contra to cost of service principles; the data included by the New York State companies cited in the AGA report is misleading; there is uncertainty with Marcellus gas (local production) and how it will impact gas supply and capital projects (marketers may purchase more local production which may lead to even more excess capacity); and, there were problems with the second stage filing in the most recent rate case.

Q. Did the Company state that there was enough Commission oversight in the budgeting process?

A. Yes.

Q. Do you agree?

A. We believe that Corning's budgeting documentation needs to be improved.

Q. Please explain.

A. As explained in the Gas Rates Panel's testimony, the Company does not have: a comprehensive strategic plan; policies and procedures for initiating, developing and executing capital projects; a project prioritization system; defined project management performance measures; and, a system to ensure that projects receive timely, appropriate review and authorization when expenditures exceed initial authorizations. We, therefore, believe there is insufficient documentation for the Commission to monitor capital spending beyond the rate plan.

Q. Does the Gas Rates Panel recommend that the Company develop estimation and justification documentation to support its Capital Spending program?

A. Yes.

Q. Then why is the Panel concerned with not having sufficient data to monitor capital expenditures?

A. The Company has demonstrated poor performance with complying with Commission requirements. For example, the Commission said it was important to develop monthly variance reports in Case 07-G-0772 and it took Corning until 2011 to develop them on a monthly basis.

Q. Did the Company propose to recover carrying charges on all capital expenditures actually made?

A. Yes.

Q. Does the Panel have concerns with this proposal?

A. Yes. This is quite different than forecasting a level of capital expenditures as is done in rate cases. Providing a true-up for all capital expenditures is like an open “check book.” Two things may occur. First, there can be significant bill impacts for capital expenditure over-runs which will cause bill volatility. Second, the burden is shifted to Staff to determine if the over-runs were necessary and/or justified and it decreases the incentive for the Company to control costs.

Q. Did Staff have concerns with limiting the second stage capital expenditures in Case 08-G-1137?

A. Yes. The agreement allowed the Company a full true-up on mandated and reliability work on Line 15, but had a hard cap for all other spending (15% above the Company's forecast) precisely because of the reasons just mentioned.

Q. Why are you also concerned with charging customers volumetrically for capital expenditures?

A. Charging customers volumetrically for capital expenditures will produce higher bill impacts for high use customers. The process is contrary to cost of service principles. It can lead to large discrepancies in service class rate of returns vs. what the service class should pay in the surcharge period.

Q. What is the AGA?

A. From the organization's website, it is an organization that represents 201 local gas distribution companies in the country advocating for the interests of its members.

Q. Is Corning a member?

A. Yes.

Q. Did the Company provide the source of its AGA cites?

A. In response to IR DPS-17, the Company provided the AGA report dated April 2011.

Q. Do you believe that the Commission should rely on the AGA report in support of a CSM that would reconcile all of Corning's capital expenditures?

A. No.

Q. Please explain.

A. Corning cites the AGA report which advocates for special surcharges, trackers, deferrals or alternative rate designs for infrastructure required to maintain and improve safety and reliability because of the concerns that credit agencies have with timely recovery of expenditures. However, the New York State utilities' mechanisms that are cited in the AGA report are not in place to recover all capital expenditures and are not in place because of the concerns of the credit agencies. In addition, the way in which rates are set can influence the lag between incurring costs and cost recovery. According to the Company's response to IR DPS-17, we do not know if any of the other states cited use a fully forecast rate year. We, therefore, do not know if that is a reason for having a specific recovery mechanism. We also do not know if any of the utilities have credit problems, which could also be a reason why a commission would develop a mechanism to provide relief for utilities. The AGA report does not state if there were offsets in the local distribution companies' ROE for the special mechanisms because the risks of capital recovery were eliminated. Since the New York State references are misleading, the Commission should not rely on the document because the other states reported mechanisms may also be misleading. Further, Corning did not provide any evidence that the rate recovery impacted its ability to access the markets.

Q. What New York State local distribution companies are referenced in the report?

A. Corning, National Grid Long Island, National Grid New York City (NYC) and National Grid Niagara Mohawk.

Q. On page 12 of that document, does it state, "Corning natural Gas has had a limited pipeline replacement cost recovery mechanism since 2006."

A. Yes.

Q. What is the Commission authorized pipeline replacement cost recovery mechanisms that were effective in 2006, 2007, 2008, 2009 and 2010?

A. In the response to IR DPS-73 the Company stated that from 2006 until August 31, 2010, Corning recovered the costs of the Commission’s mandated pipe and service replacement programs in base rates. The costs for the twelve months ended August 31, 2011 will be recovered through the second stage approved in Case 08-G-1137.

Q. How is the program that ran from 2006 until August 31, 2010 different than what Corning advocates for here?

A. The AGA program advocates for special surcharges, trackers, deferrals or alternative rate designs for infrastructure required to maintain and improve safety and reliability. For the period 2006 until August 31, 2010, Corning recovered its mandated pipe and service replacement programs in base rates. This is not a unique cost recovery mechanism, rather this is the standard way costs are forecasted and delivery rates are set.

Q. Also, on page 12 of that document, does it state, “National Grid Long Island has had a limited infrastructure replacement tracker program since 2008.

The program allows the utility to track only the costs of new or replacement infrastructure that is necessitated by city and state construction projects. These costs are rolled into rates and recovered from customers. No other infrastructure investment costs are allowed this treatment. There are no caps on the amount of money that may be recovered through the mechanism, and no rate case is required to implement the program.”?

A. Yes, and National Grid NYC, on that same page, refers to the National Grid Long Island write up.

Q. Can you provide some context to the program that National Grid Long Island and NYC refer to?

A. The deferral mechanism was developed in the merger Case 06-M-0878 (issued September 17, 2007). The parties were concerned about the accuracy of the infrastructure that was necessitated by city and state construction projects. The city and state budgets were about 30% for National Grid NYC and about 7% for National Grid Long Island. It is important to note, however, that the mechanism excluded the Commission mandated work. The AGA report fails to mention that the mechanism only kicks in if the actual city and state construction expenditures exceeded the forecast by 20%. City and state expenditures are only a portion of the overall budget and the reason this "tracker" was allowed on this portion is because these expenditures were not easily forecast and directly related to city and state work projects as well as the level of reimbursement from said entities and, therefore, outside of management's control. This is much different from what Corning is advocating for here.

Q. On page 12 and 13 of the report document, does it state, “Niagara Mohawk has had a limited pipeline replacement cost recovery mechanism since 2008.”

A. Yes. The report describes the limited program as ordered by the Commission to replace an incremental ten miles a year above the 20 miles that was already required. The new five year program allowed Niagara Mohawk to defer the costs to achieve the incremental pipe replacement until the Company’s next rate filing.

Q. Did the requirement also come out of the merger case?

A. Yes.

Q. How is this program different than what Corning advocates for in its testimony?

A. A condition of the merger required National Grid to increase the amount of miles it was replacing. The Commission recognized that if it required the Company to do more work outside of a rate case, it had to provide funding because there was an incentive associated with the target.

Q. Does the Company have plans to utilize more local production to serve its firm customers?

A. Yes.

Q. How can the increase in Marcellus production in Pennsylvania and New York impact the Company?

A. Marcellus will most likely have a significant impact on the capital expenditure program and the capacity assets the Company needs to serve its customers. We believe that it would be better to have the Company file for rates after the rate plan so that these factors can be considered.

Q. Did the Commission adopt a limited surcharge mechanism in Case 08-G-1137?

A. Yes. The Commission adopted a limited second stage increase if Corning did not file for a base rate increase before October 1, 2010.

Q. What did the Company file for in that proceeding?

A. On August 19, 2010, the Company filed for a second stage adjustment in the DRA of $510,123 reflecting carrying costs of $431,258, property tax expense of $24,187 and book depreciation expense of $54,678. Included in the Company’s capital expenditure forecast were the Compressor Station project’s carrying costs and costs associated with the upgrade of Line 15 and the Intergy storage project. In addition, the Company included book depreciation expense and an alternative capital expenditure forecast in response to the Commission’s Gas Supply Order in Case 08-G-1137 (issued June 21, 2010). Finally, the Company also requested the Commission extend the second stage mechanism to a third and fourth stages to avoid the need for a base rate increase a year from now.

Q. What did the Commission ultimately determine?

A. The Commission allowed Corning to recover an estimated second stage adjustment of $163,996 consisting of $138,809 of carrying costs and $24,187 of property tax expense. A large difference from what Corning had originally filed.

Q. Is the Panel concerned with how Corning filed its second stage compliance filing in Case 08-C-1137?

A. We are very concerned with what Corning included in the second stage compliance filing. It took a significant amount of Staff resources to fix the Company's filing to meet the requirements of the Commission's current rate order.

Q. If the Commission believes that a CSM should be adopted, what should be considered in its development?

A. While we oppose a CSM, our preference is that the capital expenditures should be strictly limited to work mandated by the Commission with a very specific list identifying the projects that can be recovered to prevent the problems encountered in the second stage filing noted above. The Commission should also use the Other Customer Capital Rate to be applied to carrying charges as it does with its RDM or gas adjustment clause (GAC) reconciliations because the Company does not have the risk of not recovering the capital costs. The Commission should consider a level of operation and maintenance savings and offset the carrying charges by the estimate. The Commission should also require that all of the estimation and justification documentation and a risk prioritization analysis be developed and filed with the capital budgets to be reviewed by the Commission, and the Company should be required to complete safety/reliability type projects first. The Company should be required to report its capital expenditure budgets and file quarterly monthly variance reports with Staff. If the Commission were to consider all of the capital expenditures, there should be a hard cap that the Company should not exceed recovery on to limit bill impacts and encourage cost control.

<u>Future Virgil Expansion</u>

Q. Did the Company include capital expenditures for a future Virgil franchise expansion?

A. Yes, on Exhibit CNG-8, Schedule 1, page 4 of 12, Project 14.1 the Company budgeted $340,000 for 2011 and on page 6 of 12, Project 14.1 the Company budgeted $150,000 for 2012.

Q. Did the Company include revenue and expenses for the Virgil franchise expansion?

A. According to its response to IR DPS-88, question 4c, no revenues and expenses are included in the rate request.

Q. In order to expand outside of its current Virgil footprint, does Corning need to seek Commission approval?

A. Yes, in Case 09-G-0252 (issued June 19, 2009) the Commission stated that the Company needed further Commission approval for a further franchise expansion.

Q. Has Corning applied for a franchise expansion in the Town of Virgil?

A. On September 16, 2011, Corning filed for a Virgil franchise expansion.

Q. Did Staff file a motion to strike the pre-filed direct testimony of Company witness Cook related to the capital expenditures for a future Virgil franchise expansion?

A. Yes, Staff filed the motion on July 15, 2011 and argued that it was premature to include the expenditures and revenues in this case.

Q. What is the disposition of that motion?

A. On August 2, 2011, it was decided that "consideration of the limited issue of projecting ratemaking impacts of expenditures for the proposed Virgil expansion is appropriate in this proceeding."

Q. Did Staff exclude the capital expenditures associated with the expansion outside of its current Virgil footprint in this proceeding?

A. Yes, again we believe it is premature to require customers to provide a return on capital expenditures for a project that first requires Commission approval. And, there is not a sufficient amount of information for Staff to review in the rate filing. We do not know if the costs and revenues are reasonable because the Company did not forecast them. Further, we do not know if the Commission will required specific write downs as it did in the original Virgil franchise case.

Q. Is there a Policy Statement on the treatment of Franchise expansions?

A. Yes, Case 89-G-078 (issued December 11, 1989).

Q. If the franchise expansion passes the five year economic test, what is the ratemaking treatment afforded to that new area?

A. The Policy Statement states that if the Commission approves a franchise expansion, it will be afforded normal ratemaking treatment in the next base rate filing.

Q. What delivery rates do customers in Virgil pay?

A. Virgil customers pay PSC No 4 tariff delivery rates. In our tariff proposal, these rates would be applicable to all of Corning’s customers.

Q. Can you project the impact this expansion will have on all of Corning customers?

A. No. Corning only included the capital expenditures and excluded associated revenues and expenses in its rate filing. We do not know the franchise footprint and associated revenue and expenses the Commission may potentially approve. We, therefore, cannot project the impacts this expansion will have on Corning’s customers.

Q. Did Staff’ motion address any other issues related to Corning’s rate filing?

A. Yes, in the same ruling it was decided to strike any testimony related to Corning’s request for a Holding Company and a transfer of certain utility assets, so we, therefore, will not be addressing those issues here.

<u>Exogenous Costs and Generic Policy Actions</u>

Q. How does the panel propose to address exogenous costs and generic policy actions?

A. Exogenous costs including any credits are defined as the incremental effects on Corning’s expenses, revenues or rate base (including income or other federal or state tax expense and local property taxes) caused by any externally imposed changes in the federal, state or local rates, laws, regulations, or precedents governing income, revenue, sales or franchise taxes; or any legislative, court, or regulatory change, which imposes new or modifies existing obligations or duties (or only repeal or amendment to an existing law, rule, regulation, order or requirement). Also, mandatory changes due to generic policy decisions of the Commission shall also be treated in a similar manner. If such an event results in either an increase or decrease in the utilities cost of service in any one rate year ending April 30th to the extent that each separate item results in an annual revenue requirement impact greater than $118,462 in rate year one, an impact greater than $133,690 in rate year two and an impact greater than $143,257 in rate year three, which would be in excess of the Commission’s materiality threshold for deferral accounting, the Company will be required to petition for the full revenue requirement effect of any such event. Any such deferral will accrue interest at the Unadjusted Customer Deposit rate and shall be recovered from or refunded to customers in the future in a manner to be determined by the Commission. No regulatory deferrals will be authorized to the extent that the Company’s earnings before sharing exceed the allowed ROE of 9.7%. In the event that exogenous costs or mandatory changes are incurred, Corning should file a letter with the Secretary of the Commission setting forth the rationale for the deferral and its calculation. Any disagreement associated with the filing shall be referred to the Commission for decision. Also, the Company may have a change in accounting that results in a change in the Company’s revenue, expenses and rate base not anticipated in the forecasts for the rate plan. The Company will notify the Secretary of the Commission of such changes 60 days before they are to take effect. The notification should describe the change, why it is required and quantify the first year revenue requirement impact resulting from the change. If such a change results in an increase or decrease to the utility’s cost of service having an annual revenue requirement impact greater than 5% of income available to shareholders the Company will be required to petition for deferral of the full revenue requirement effect of any such change.

<u>Deferral Accounting</u>

Q. How does the Panel propose to address the Company's filing of petitions for deferral accounting?

A. If the Company elects to file a deferral accounting petition the utility bears the burden of proving the item is incremental to the existing rate allowance, demonstrating that the incremental cost is material and that the Company is not earning above its authorized ROE and will not after reflecting the deferral. The current materiality standard is measured at 5% of the income available to shareholders. The Company's petition should provide at a minimum evidence that the costs were beyond management's control, or could not have been reasonably forecast in setting rates, that reasonable actions were taken to mitigate the costs and the costs are recoverable consistent with Commission policies.

Q. Does this complete your testimony at this time?

A. Yes it does.